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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE MARCH 2003

OVERVIEW

- In the fourth quarter of 2002 real gross domestic product (GDP) increased 1.6%, a slower pace than in the first three quarters of the year, reflecting weaker exports, in particular automotive exports to the United States. For 2002 as a whole, real GDP grew a solid 3.4%, more than double the pace in 2001.
- Final domestic demand registered a stronger gain in the fourth quarter than in the third. This was led by solid growth in consumer spending and a robust increase in residential investment. However, business investment in plant and equipment decreased 1.5%.
- Real exports dropped 8.0% while real imports declined 1.0%. As a result, the trade surplus fell, contributing to the current account surplus narrowing $3.7 billion to $13.2 billion.
- From January 2002 to February 2003 the Canadian economy created 613,000 net new jobs, the largest employment gain over any 14-month period on record back to 1976. The unemployment rate in both January and February 2003 was 7.4%, down from its recent peak of 8.0% in December 2001.

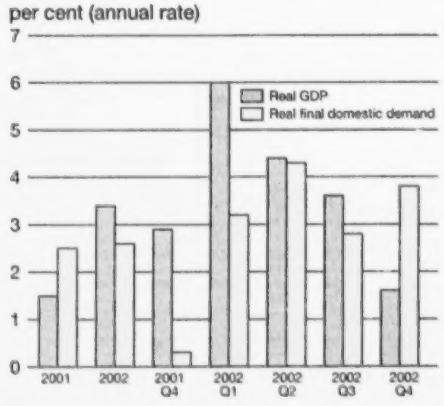
Domestic demand drives growth

Real GDP grew 1.6% in the fourth quarter of 2002, a slower pace than the 4.7% average in the first three quarters of the year. Stronger domestic demand led the gain, increasing 3.8% in the quarter (Chart 1).

Consumer spending contributes to growth

Real consumer expenditure growth increased to 4.4% in the fourth quarter compared to 1.6% in the third. Gains in household spending were widespread among the major categories. The increase was especially noticeable in durables. Motor vehicle sales rose sharply and the continued strong housing market boosted spending on furniture and appliances.

Chart 1
Growth in real GDP and real final domestic demand



Note: Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is noon, March 7, 2003.

Main economic indicators
(per cent change at annual rates unless otherwise indicated)

	2001	2002	2002:Q2	2002:Q3	2002:Q4	Most recent	
Real gross domestic product	1.5	3.4	4.4	3.6	1.6		–
Final domestic demand	2.5	2.6	4.3	2.8	3.8		–
Government expenditure							–
Goods and services	3.3	2.0	3.6	3.0	3.5		–
Gross fixed capital	11.5	8.7	5.6	3.3	-0.8		–
Consumer expenditure	2.6	2.9	4.3	1.6	4.4		–
Residential investment	4.7	16.0	-1.8	16.3	11.3		–
Business fixed investment	-1.1	-3.9	7.6	2.4	-1.5		–
Non-residential construction	0.8	-6.4	-4.8	-1.1	-3.2		–
Machinery and equipment	-2.2	-2.4	15.8	4.6	-0.4		–
Business inventory investment ($ billion)	-3.5	4.4	7.1	7.4	9.6		–
Exports	-3.8	0.8	2.6	9.4	-8.0		–
Imports	-5.8	0.8	19.8	6.5	-1.0		–
Current account balance							
(nominal $ billion)	30.0	17.3	17.2	16.9	13.2		–
(percentage of GDP)	2.8	1.5	1.5	1.5	1.1		–
Nominal personal income	4.0	3.2	2.5	3.4	5.3		–
Nominal personal disposable income	4.4	4.5	3.6	3.3	4.2		–
Real personal disposable income	2.5	2.5	0.2	0.3	2.3		–
Profits before taxes	-8.9	6.2	51.1	10.4	11.5		–
Costs and prices (%, y/y)							
GDP price deflator	1.0	1.2	0.1	1.8	4.2		–
Consumer price index	2.6	2.2	1.3	2.3	3.8	4.5	Jan-2003
CPI excluding eight most volatile items	2.0	2.4	2.2	2.4	2.8	3.3	Jan-2003
Unit labour costs	2.8	1.2	0.9	0.9	2.0		
Wage settlements (total)	3.1	2.8	2.6	2.8	3.2	2.9	Dec-2002
Labour market							
Unemployment rate (%)	7.2	7.7	7.6	7.6	7.6	7.4	Feb-2003
Employment growth	1.1	2.2	3.6	3.5	3.2	4.3	Feb-2003
Financial markets (average)							
Exchange rate (cents U.S.)	64.6	63.7	64.4	64.0	63.7	68.00	06-Mar-03
Prime interest rate (%)	5.2	4.2	4.1	4.5	4.5	4.75	06-Mar-03

Note: Real values are in chained 1997 dollars.
Sources: Statistics Canada, the Bank of Canada and Human Resources Development Canada.

Personal income increased a solid 5.3% in the quarter, as employment and wage gains boosted earned income. Real personal disposable income increased by more than 2%, and real personal disposable income per capita rose to near its record level and stood more than 13% above its most recent low in 1996.

The personal savings rate fell from 4.2% in the third quarter to 3.7% in the fourth.

Residential investment continues to be strong

Low interest rates continued to support the housing market. Residential investment increased 11.3% in the fourth quarter to stand 14.8% above its level of a year earlier. Housing starts rose modestly in the quarter, contributing to a 12.2% increase in new construction. Growth in spending on renovations remained solid. Activity in the house resale market also registered a solid gain.

Business fixed investment falls

Business spending on plant and equipment decreased 1.5% in the fourth quarter, following a gain of 2.4% in the third. Investment in import-intensive machinery and equipment dipped 0.4% after rising in the three previous quarters. Businesses reduced spending on automobiles and continued to cut their investments in telecommunication equipment. Expenditures on industrial machinery, computers and software rose.

Non-residential construction decreased for the sixth consecutive quarter. This reflected reduced spending on engineering projects and building construction.

Businesses add to inventories

Businesses boosted inventories $9.6 billion in the fourth quarter, up from the $7.4-billion inventory investment registered in the third. Retail motor vehicle inventories accounted for almost half of this buildup while the remainder was broad-based across the manufacturing sector. As sales grew more modestly than inventories, the inventory-to-sales ratio edged above its all-time low level.

Exports subtract from growth

Real exports subtracted from growth, dropping 8.0%. The weakness was largely in automotive exports as motor vehicle sales in the United States, the destination of most Canadian automotive production, plunged in the fourth quarter. Exports of energy products rose sharply as did those of services, especially non-resident spending on travel in Canada.

Real imports dropped 1.0%, with particular weakness in automotive parts. This reflected the reduced need for imported parts for Canadian production since exports of motor vehicles dropped. Imports of services edged up as Canadians spent more on international travel.

Current account surplus remains high

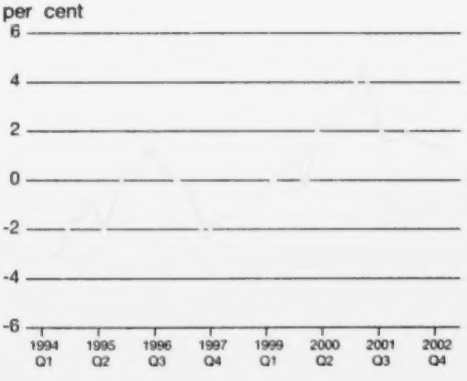
The current account surplus decreased $3.7 billion to $13.2 billion or 1.1% of GDP (Chart 2). While the greater decline in real exports than imports lowered the trade balance, this was partly offset by an improvement in the terms of trade (export prices rose more than import prices). A jump in dividends paid to non-residents also pushed down the current account surplus.

Despite declining throughout the year, the current account surplus stood at $17.3 billion for all of 2002, the third consecutive year that it exceeded $17 billion, a level never reached before 2000.

Inflation moves higher with energy prices

The GDP deflator, a comprehensive measure of inflation, rose 5.0% in the fourth quarter, to stand 4.2% above its level a year earlier. The fourth-quarter rise was driven largely by a jump in the price of exported energy products. The pace of growth in the consumption deflator moderated in the fourth quarter.

Chart 2
Current account as a percentage of nominal GDP



Year-over-year consumer price inflation rose to 4.5% in January, as energy prices jumped. Core CPI inflation, which excludes the eight most volatile items, was 3.3%, slightly above the target band of 1% to 3%.

Corporate profits climb higher

Corporate profits increased 11.5% in the fourth quarter. This fourth consecutive double-digit gain raised profits' share of GDP to 11.3%, well above the historical average of 9.9%. The vibrant housing market boosted construction industry profits. Higher energy prices helped petroleum and coal producers while increased energy exports benefited the oil and gas extraction industry. Strong domestic motor vehicle sales boosted retail sector profits. However, profit growth moderated in manufacturing overall, especially in the automotive sector, as U.S. demand softened.

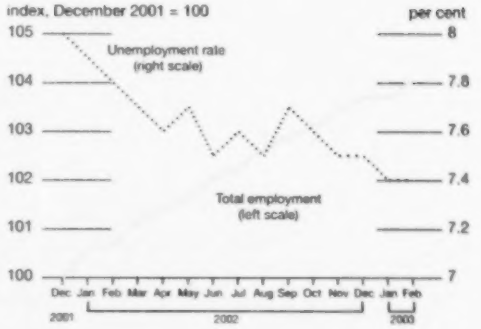
Employment continues to rise

Employment jumped 3.2% in the fourth quarter, bringing job creation since December 2001 to 560,000. The majority of the jobs created were full-time.

The strong labour market induced 522,000 people to enter the labour force during 2002. This raised the participation rate to 67.5% in December, a level equalled only once before in January 1990.

The economy added another 53,000 jobs in January and February 2003. All were full-time. The participation rate again stood at a record 67.5% in February while the unemployment rate was 7.4% in January and February, compared to 7.5% in December 2002 and 8.0% in December 2001 (Chart 3).

Chart 3
Employment and the unemployment rate



Bank of Canada raises its policy rate

On March 4, the Bank of Canada raised its key policy rate 25 basis points, citing "domestic inflation pressures, the expectation that Canadian economic activity will remain near potential in 2003, the stimulative stance of monetary policy, and improved conditions in capital markets."

Canadian short-term interest rates have risen modestly during 2003 while those in the United States have been steady, widening the spread between Canadian and U.S. short-term rates. Long-term rate differentials have also increased modestly.

The value of the Canadian dollar has risen relative to the U.S. dollar in recent months, attaining values in early March last seen in July 2000. It closed at 68.00 cents U.S. on March 6.

The main source of data used in this publication is Statistics Canada. Subscription inquiries should be directed to the Distribution Centre at (613) 995-2855. For other inquiries about this publication, contact Mostafa Askari at (613) 992-3055.
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